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AMERICAN WAR-FINANCIERING.

THE prosecution of a war of such magnitude as to call for large expenditure of money, imposes upon the minister of finance the duty of adopting a policy for the management of the public treasury. Under modern industrial conditions, however, his choice is quite restricted, for there are but three proposals which it is worth his while to consider. These proposals are as follows:

First. The entire war expenditure may be drawn from newly levied taxes. In the administration of this policy, the only loans required are loans in anticipation of tax receipts, in order to cover the demands upon the treasury during the period in which the new revenue system is becoming operative.

Second. The entire expenditure of the war may be met from the proceeds of loans. In this case there is a call for new taxes equal to the interest upon the loans contracted. Sometimes even interest payments are met by selling new bonds, but this is so manifestly at variance with sound rules of finance that it need not be considered.

Third. The extraordinary expenditure entailed by the war may come from a reasonable union of these two sources of revenue — loans and taxes. The important question presented by this policy pertains, of course, to the nature of the union proposed and to the ratio of proceeds from loans to proceeds from taxes; and it is further necessary to inquire if this ratio is the same for all stages of the war.

It must be remembered throughout the investigation in this

manner laid before us, that our problem has primarily to do with extraordinary expenditure; that is to say, with expenditure over and above the demands of peace.

Nor does this properly present the extent of the problem. It is more than likely that some of the ordinary sources of revenue will be cut off by a state of war, so that new ways of securing money must be discovered to meet the deficits in permanent demands. An adequate financial policy, therefore, must be more than sufficient to make headway against war expenditures.

I.

Shall the entire extraordinary expenditure entailed by a war be met by an exercise of the taxing power?

This question brings us at once into the presence of a claim respecting which there is great diversity of opinion. There are those who assume, without proof or argument, that a people engaged in an exhaustive conflict are unable to bear any marked increase in taxation, so long as the conflict shall continue. There are others who, stopping short of this extreme claim, yet urge it as highly desirable that the burden of a war should be distributed over several generations. From such premises the adoption of the loan policy must logically follow. As opposed to such opinions, there are writers of respectability and standing in finance who deny the inability of a people to meet within the year all necessary expenditure, and who refuse assent to the time-honored argument that by a loan the burden of war may be diffused. Such writers claim that the generation engaged in the contest must bear the burden of its expense; that this burden can in no manner be bequeathed; but that, if the war entail a debt upon following generations, its burden is borne twice — once by the fathers who furnished the capital that was destroyed, and once by the sons who furnished the money to expunge the debt. Although this latter conception of war expenditure does not appear to me to be quite accurate, it is yet based upon the

manifest truth that each generation must subsist upon the product of its own industry.

Such a statement of truisms, however, is no final argument in favor of the taxing policy, nor does it meet fairly the claim of those who say that by means of loans the burden of a conflict may in part be thrown upon posterity. They who claim that war expenditure should be entirely met from the proceeds of taxes, fail to recognize two very important facts. In the first place, they fail to understand the difference between capital expended in a war, and the burden entailed upon the citizens of a country by a war. The consumption of capital may or may not give rise to the consciousness of extraordinary expenditure on the part of the state, according as it does or does not cause involuntary privation. The real burden of a war consists in the fact that men are deprived of property without the compensation of hope. In the second place — and here lies the kernel of the argument — they fail to perceive that the most important factor for the financier is not the material but the psychological factor. It stands as a first principle in an adequate war policy that, however great may be the demand for a current year, it should be met in such a manner that the source from which supply is drawn may never be exhausted. The appeal of the financier to the industrial producers should be made in such alluring language that, while continually giving of their product to the state, their energy will not be abated. The fund of current product, from which all revenue is drawn, should be as unfailing as the widow's cruse of oil.

It may appear, at first glance, that the realization of this principle in actual treasury management is impossible; but it is perfectly feasible, provided only a proper financial policy be adopted. It is an error to suppose that current consumption in time of war is largely increased over average consumption in time of peace. Public consumption may be greater, but private expenditure is curtailed. Unless mercenaries are brought from abroad, no more of the necessities of life are required than before the mobilization of the army, and on

the average such as are consumed will be of no better quality. To balance the increase of capital required for the manufacture of arms, powder, ships, and the like, there is a decrease in the rapidity with which capital is invested in forms adapted to peace employments. It is, however, necessary to notice that average production cannot be maintained except by unusual exertion on the part of non-belligerents, for the ranks of peace workers will have been depleted by enlistments in the army. This call for increased activity is, in reality, the first tax sustained by those who continue to follow the common pursuits of life. But this tax need not be the occasion of solicitude, for established habit may be relied upon to tide over this first draft of men from the industrial ranks. A farmer, who with three sons has been accustomed to cultivate a section of land, will not permit a hundred and sixty acres to lie fallow because one of his sons has joined the army. It is a truth of quite general application, that men are disinclined to fall below a standard once achieved; and it is upon this principle of human nature that the financier may rely for the maintenance of average production notwithstanding the reduction in laboring force.

The real question, then, that confronts the financier is the following: Can he hope that this increased activity will be maintained if, in addition to the labor tax, he levy a money tax equal to the entire expense of the war? To answer this question in the negative is not to deny whatever is true in the claim that taxes have a tendency to quicken production. A tax levied for that purpose must gradually, and persistently, and through a long series of years, raise the rate of impositions; the desired result will not follow if industries be subjected without warning to excessive charges. For example— is it reasonable to believe that the industry of the Northern states would have been spurred to increased activity, if the total war expenditure of 1862 had been met by taxation? Government expenditure for that year was equal to one-quarter of the total national product, while the extraordinary war expenditure was equal to one-fifth of the product. Assuming

that the newly levied taxes would have brought in the money for 1862, can one suppose that the year 1865, when war expenditure amounted to twenty-seven per cent of gross product, would have produced an adequate amount of disposable capital? No one who understands the psychology of taxation can for a moment admit such a claim. A tax so excessive in amount, precipitated without warning upon established industries, would have encroached upon working profit, weakened the incentive to labor, broken the mainspring of activity, and destroyed the mechanism of production. It would, therefore, have disregarded the first principle of treasury management, for it would have dried up the source from which all revenue must come. An adequate policy for the conduct of a war must be able to carry a people through to the end, and not expose them to the danger of a treasury stranded in the midst of the conflict.

If, on the other hand, a part of the extraordinary expenditure should be met by an appeal to credit, the loans placed would be largely absorbed by free capital. This would cause no derangement of industries, and the sacrifice entailed would be voluntary. The idea of loss would not attend the payment of capital to the state, but rather the thought of establishing a permanent income would induce to renewed activity. The administration would run no risk of exhausting the fund from which future revenue must be secured, for it would be continuously replenished by willing hands. Now it is altogether by the mark to say that loans must in the end be paid from the proceeds of taxes and that, in consequence, the advantage of an appeal to credit is apparent and not real. The question is, whether the desire to avoid future taxes can induce men willingly to suffer the burden of present payments. If they truthfully declare such a willingness, there can be no necessity for the employment of public credit. But if, as an analysis of human character shows, the potency of motives is inversely as the remoteness of interests concerned, this abstract truth, that taxes must finally equal sums borrowed, cannot be relied upon to induce men to practise self-restraint in consumption and to undergo

severe toil in production in order that the springs of revenue may be ever flowing. It is such considerations as these that lead us to regard the taxing policy as inadequate to the demands of an exhaustive war.

II.

Shall the extraordinary expenditure imposed by war be met entirely by the proceeds of loans?

The policy which is here brought to view has been a favored one with financiers. The general claim in its favor is, that while a people are engaged in war their industries should be freed from all unnecessary encumbrances, in order that they may supply the "extra product" which the "extra consumption of the government" demands. The conclusion of such reasoning is, that while a war lasts no new taxes should be imposed.

It has been already observed, in the foregoing discussion, that the conception here presented is erroneous. The consumption of a people engaged in war is not greatly in excess of peace consumption. It may, if necessary, be brought down to less than peace consumption. An adequate financial policy demands only that average production should be maintained. It is true that average production calls for more intense application on the part of non-belligerents, but if business men are not discouraged by an erroneous financial policy, the industrial habits of the people may be relied upon to attain this end. Indeed, the administration may reasonably hope that a certain amount of taxes will be willingly paid in addition to what was termed above the labor tax. The motive or force which the financier must call into play to secure so desirable an end is patriotism. If the purpose of the government be fully appreciated and approved, a free people will gladly support heavy burdens in order to carry out an adopted policy. It is a recognized fact that self-governing peoples are stronger for tax purposes than the subjects of a monarchical state, for their will lies more closely to the heart of the state. But the administration of a self-governing people should never undertake a war in favor of which there is no strong sentiment. As things go,

then, in democratic countries, it does not appear that loans to the full extent of extraordinary demands are necessary, and there is no question as to the superiority of taxes over loans when their use will not curtail industrial energy. The measure of this first money tax should be the popular enthusiam for the war.

What, however, is the specific argument against the policy of securing the entire war revenue from loans? Many considerations might be presented showing the dangers that beset this method of financiering; but a study of certain attempted realizations of it may, perhaps, disclose its inadequacy most clearly. There are very few cases in which a struggle of any magnitude, testing at all a people's financial resources, has been carried to a successful issue on the basis of a loan policy; while there are many instances of an abandonment of this policy during the progress of a war, which itself must be accepted as confession of failure. Twice in the history of our own country has this fatal over-confidence in the sufficiency of public credit brought a rich and energetic people to feel the stress of a demand for money and to experience the evils of ruinous and expensive methods of treasury control. It is not true that the actual failure of any policy proves the impossibility of its success; but it is true that a study of several instances of failure will permit one to decide whether continued ill-success is due to inadequate management or to erroneous principles in the policy itself. Understanding, then, the limitations rightfully placed upon all arguments from history, let us turn our attention to the financial management of the two great wars in which the United States has been engaged — that of 1812, and that of 1861.

The financial policy which was adopted for the conduct of the war of 1812 finds its first statement in the Treasury report of 1807. This has been called the war-report of Albert Gallatin. The reason why so astute a politician forced this question thus early upon the attention of Congress may not, perhaps, with clearness be determined; it is sufficient for our present purpose to notice the fact. The financial condition of the Treas-

ury at this time was as follows. The permanent revenue of the country was estimated at $14,500,000, while the permanent expenditure for peace purposes was estimated at $11,600,000. In this expenditure, however, there was included an annual payment on account of the debt service of $8,000,000, which would be reduced to $3,400,000 after 1808, because of the inability of the government to proceed as rapidly as heretofore in expunging the debt. Taking this into account, the permanent expenditures on a peace basis could not exceed $7,000,000, and this would provide a permanent annual surplus of $7,500,000.

It was in the presence of such financial prospects that the Secretary spoke his views on the proper method of treasury administration in the event of a commercial war. His plan may be best presented in his own words, which are as follows:

That the revenue of the United States will, in subsequent years, be considerably impaired by a war, neither can nor ought to be concealed. It is, on the contrary, necessary, in order to prepare for the crisis, to take an early view of the subject, and to examine the resources which should be selected for supplying the deficiency and defraying the extraordinary expenses.

There are no data from which the extent of the defalcation can at this moment be calculated, or even estimated. It will be sufficient to state, first, that it will be necessary to provide a revenue at least equal to the annual expenses on a peace establishment, the interest of the existing debt, and the interest on the loans which may be raised. Second, that those expenses, together with the interest of the debt, will, after the year 1808, amount to a sum less than $7,000,000, and, therefore, if the present revenue of $14,500,000 shall not be diminished more than one-half by war, it will still be adequate to that object, leaving only the interests of war-loans to be provided for.

Whether taxes should be raised to a great amount, or loans be altogether relied on for defraying the expenses of the war, is the next subject of consideration.

Taxes are paid by the great mass of the citizens, and immediately affect almost every individual in the community. Loans are supplied by capitals previously accumulated by a few individuals. In a country where the resources of the individuals are not generally and materially affected by the war it is practicable and wise to raise by taxes the greater part at least of the annual supplies. The credit of a nation may also from various circumstances be at times so far impaired as to leave no re-

source but taxation. In both respects the situation of the United States is totally dissimilar.

There is no question but that the Secretary here expresses full confidence in the adequacy of the loan policy to meet the financial stress of a war. It is true that he suggests the levy of certain new taxes, but their purpose is "to provide for the interest of war-loans, and to cover deficiencies in case the existing revenue shall fall below $7,000,000." He does not contemplate taxation as a means of defraying war expenditures.

A clearer statement of this policy is to be found in the report of 1808.

> No internal taxes [says the Secretary] either direct or indirect are therefore contemplated, even in the case of hostilities carried on against the two great belligerent powers.

And the report of 1809 comes back again to the same thought.

> Loans reimbursable by installments, at fixed periods, after the return of peace, must constitute the principal resources for defraying the extraordinary expenses of the war.

So far, then, there can be no question as to Mr. Gallatin's views respecting the financial conduct of a war; but the impression has somehow arisen that the events of the years 1810 and 1811 caused him to modify the opinions which he had previously expressed, and to urge upon Congress the adoption of taxes to a degree wholly at variance with his original plan. There is, however, no evidence which warrants one in the belief that the Secretary had abandoned the theory of loan financiering; but on the other hand, in a letter of January 10, 1812, addressed to the chairman of the Committee of Ways and Means, there may be found a restatement of the loan policy, perfect in every essential particular. It is true that the committee was recommended to urge the establishment of both direct and indirect taxation, but this was due to the fact that revenue from customs had fallen below the estimates of peace demands. These taxes, therefore, could not with propriety be termed "war-taxes," since their proceeds were to be devoted to cover peace expenditure.

It may be proper to repeat [says Mr. Gallatin] that, so long as the public credit is preserved, and a sufficient revenue is provided, no doubts are entertained of the possibility of procuring, on loan, the sum wanted to defray the extraordinary expenses of a war; and that the apprehensions expressed relate solely to the terms of the loans — to the rate of interest at which they can be obtained.

Again in another place he says: "In proportion as the ability to borrow is diminished, the necessity of resorting to taxation is increased." Such a sentence as this could not have been written except by one who had turned his back squarely upon the policy of war-taxes. It regards taxes as a last resort, to be employed only when the public credit shall have been exhausted; the tax policy, on the other hand, holds loans in reserve to be used only in presence of the greatest stress.

But did the views of Congress coincide with those of the Secretary? In one particular only do we find them at variance. Mr. Gallatin desired the new loans to rest upon a permanent revenue sufficient to pay current interest, but the members of Congress had no such view of this necessity as to lead them to press to legalization the necessary bills. It was decided by the Committee of Ways and Means that a war of four years' duration could be carried on for $50,000,000, and in February, 1812, a loan of $11,000,000 was authorized as the sum needed for the first year. Upon the same day that the House passed the loan-bill, Mr. Bacon, chairman of the Committee of Ways and Means, made a report, in which he advocated "war-taxes," setting forth in a clear manner the policy of the administration. This committee was as yet under the control of Mr. Gallatin. The speech which attended this report is peculiar, showing as it does the excessive and absurd confidence which the advocates of the war had in war-loans. After stating that a loan of $11,000,000 was regarded as sufficient for the first year, he said:

It is assumed by the committee that the extraordinary or war expenditure of the two succeeding years shall also rest upon further loans; and it is supposed that revenue sufficient to pay only the ordinary expenses and the interest on the old debt and on new loans shall be immediately provided for by the government.

That which is peculiar in Mr. Bacon's speech is his warning to Congress against relying upon the proceeds of loans to pay the interest upon debts contracted.

> If we suffer ourselves [he said] to yield to the new theory of borrowing both principal and interest, we have no data by which to judge upon what probable terms loans may be obtained at all, or how long it will be before we must wind up business.

Still the temper of the House called for just such arguments, for there was a strong faction that held taxes for the payment of current interest to be superfluous. "How are the exigencies of the government for the next year to be supplied?" exclaimed Mr. Cheeves, who was spokesman for this faction. "Is the deficiency to be derived from taxes? No, I will tell gentlemen who are opposed to them, for their comfort, that there will be no taxes imposed for the next year." And yet in the expenditure for the next year, it was necessary to include the interest upon loans already voted. There can be no question but that the financial policy adopted at the beginning of the war of 1812 looked to credit rather than taxes as the source of all extraordinary expenditures. Let us then inquire respecting the results of this endeavor to realize the loan policy.

It is not my purpose to trace in detail the course of financial management for the war of 1812. All that is essential to the end held in view may be succinctly presented by a few comments upon the two tables that follow. In these tables will be found certain facts pertaining to the employment of public credit, whether in the form of direct loans or of an issue of treasury notes; the amounts authorized by the several acts, the amounts issued, and the conditions of their sale, will show quite clearly the degree of success that attended the administration of the loan policy. It is necessary to observe that war was declared upon June 18, 1812, and that the news of a definite treaty of peace arrived in New York upon February 13, 1815. The period covered by the tables, therefore, pertains to those financial measures considered by Congress in view of the continuance of the war, as well as to the employment of public credit for war purposes.

TABLE A.

SHOWING LOANS AUTHORIZED, AND THE FACTS CONCERNING THEIR SALE, FOR WAR OF 1812.

Date of loans authorized.	Amounts authorized.	Amounts issued.	Rate of interest (per cent).	Rate of sale.	Rate of sale estimated on gold basis.
Mar. 14, 1812	$11,000,000	$10,284,700	6	par	
Feb. 8, 1812	16,000,000	18,109,377.43	6	88	88
Aug. 12, 1813	7,000,000	8,498,581.95	6	88¼	88¼
		9,919,476.25	6	80	80
Mar. 24, 1814	25,000,000	5,384,138.87	6	82	70
		764,000	6	80–95	65–69
Nov. 15, 1814	3,000,000	1,450,000	6–7	par	81–89
Jan. 9, 1815	6,000,000	200,000	6	par	89

TABLE B.

SHOWING TREASURY NOTES AUTHORIZED, AND FACTS CONCERNING THEIR SALE, FOR WAR OF 1812.

Date of acts authorizing notes.	Amounts authorized.	Amounts issued.	Rate of interest (per cent).	Rate of sale.	Rate of sale estimated on gold basis.
Jan. 30, 1812	$5,000,000	$5,000,000	5	par	par
Feb. 25, 1813	5,000,000	5,000,000	5	par	par
Mar. 4, 1814	10,000,000	10,000,000	5	par	84–91
Dec. 26, 1814	10,500,000	8,318,400	5	par	86–90
Feb. 24, 1815	25,000,000	17,432,780	6 and 7	100–104	82–90

One of the most significant facts which a comparison of these two tables presents, is the relation that seems to exist between loans and treasury notes. As the power of Congress to secure money by the sale of bonds decreased, reliance upon treasury notes increased. The inability of the government to place bonds was recognized in the latter part of 1814; in December of that year and February of the year following, $35,500,000 of treasury notes were authorized. Turning now to a consideration of the loans proper, the record of events

shows that the first loan met with no enthusiasm. Although $11,000,000 had been authorized, and the Secretary was anxious that subscriptions should be rapid and sufficient to absorb the entire sum, he found at the end of two months that only six millions of the stock had been subscribed. Mr. Gallatin admitted the success of the loan to be "more than doubtful," and it was because of the tardy sale of bonds that Congress authorized the first issue of treasury notes. It is true that the terms of this first loan were not attractive, and that the greatest enthusiasm for the war was found outside the moneyed classes: but one must not lose sight of the fact that the only new taxes levied for the support of this loan consisted in a slight alteration of tonnage rates and a tardy increase of customs duties. The financial policy upon which this war was to be carried through appears to have shown signs of weakness before the struggle had been fairly begun.

On February 8, the following year, the government again came upon the market for money, this time demanding $16,000,000. The weakness of the previous loan was charged to the fact that too strict conditions had been imposed upon the administration in its negotiations; in this loan, therefore, as in all subsequent loans, the only condition insisted on by Congress was the right of reimbursement after a specified term of years. The passage of this act elicited much discussion, concerning both the propriety of the war and the adequacy of the financial policy. Some few members saw that loans resting on good intentions only, must lead to disaster.

> In finance [said one member] the wisdom of men has never been able to discover any effectual security to public credit, short of certain funds or revenue pledged for the redemption, and sufficiently productive to pay at least the interest of the debt.

Oddly enough, Stewart on Political Economy was quoted in support of this common-sense remark. But common sense does not seem to have been regarded at this time as essential to the guidance of a nation's finances, and no steps were taken toward an increase of taxation. This loan was placed at

88 cents on the dollar, while pressing demands were met by an additional issue of $5,000,000 in treasury notes.

Still there are many expressions which show that Congress was beginning to suspect the inadequacy of the loan policy; and at an extra session called in May, 1813, steps were taken towards laying the foundation of a system of internal revenue. But it would be an error to suppose that the original loan policy was at this time abandoned. Congress had now reached the position defined in Gallatin's financial reports, and recognized the necessity of providing some basis for the credit of the state. There is but the slightest suggestion in the report of Mr. Jones, who was then acting as Secretary of the Treasury, which looked to the employment of taxes for making headway against war demands. According to his view, the chief benefit of new taxes would accrue in enabling the government to carry out its loan policy.

> As reliance [he says] must be had upon a loan, for the war expenses of the year 1814, the laying of the internal taxes may be considered, with a view to that object, as essentially necessary; in the first place, to facilitate the obtaining of the loan; and secondly, for procuring it on favorable terms.

From the message of the President also, may one learn that the difficulty of negotiating bonds at par was regarded as the only justification of new taxes. The revenue system as adopted included a direct tax upon the several states and internal duties of various sorts. They were called "war-taxes" and, by the act that authorized them, were limited to one year from the conclusion of a treaty of peace. The adoption of this system, however, appears to have had little influence upon public credit, partly because the new sources of revenue could not be relied upon for at least a year, but more especially because the new taxes were temporary and not coexistent with the debts assigned to them.

This plan of carrying on the war by the proceeds of loans may be said to have broken down in connection with the $25,000,000 loan of 1814. To measure adequately the magnitude of this operation, it must be taken in connection with the

$10,000,000 of treasury notes authorized about the same time, from which it appears that $35,000,000 of debt were created by Congress to cover the appropriation of a single sitting. This was a sum equal to five times the average peace expenditure and to the total *ante bellum* revenue for two and a half years; and it was thought that this sum might safely rest upon the modest appeal to tax contributions just mentioned.

There is one element of complication that must not be overlooked, if the danger and uncertainty which attended the financial operations of this period are to be clearly perceived. Mr. Gallatin had relied largely for the success of his plan, as presented in 1807, upon assistance from the Bank of the United States. He thought to control the circulating medium of the country by means of this institution, and to procure much assistance in the placement of the public bonds. Nor can it be doubted that Congress, in refusing to grant a renewal of the charter of the bank, is largely responsible for the financial straits into which the government fell. The increase in the circulation of the private banks brought with it the evils of inflation even before the suspension of specie payments, which occurred in August and September, 1814. Some conception of the difficulty of carrying through any financial operation may be gained, when one learns that the government was obliged to select ninety-four state banks as the depositories of its funds; and so various were the kinds of paper money in use, that it was found necessary to keep four separate ledger accounts in each. This cannot, however, be urged as an adequate excuse for the failure of the financial policy adopted for the prosecution of this war. All that may be truthfully said is, that the failure of this policy was demonstrated more quickly than would have been the case could specie payments and clear accounts have been maintained.

From the table given above, it appears that the proceeds of the loan of March 24, 1814, are presented in three different sets of figures. This method is adopted in order that the tendencies now making their appearance at this time, in connection with treasury management, may be more perfectly disclosed.

There was authorized by this act $25,000,000 of bonds. The first call was for $10,000,000, which resulted in the receipt of $7,900,000 in cash and in the issue of $9,900,000 of 6 per cent stock. This, it will be observed, was a sale of bonds at 20 per cent discount, being a lower price by eight cents on the dollar than any which the government had previously accepted. Four months later, a second advertisement appeared calling for $6,000,000 additional of the $25,000,000 authorized. The amount of debt created by this operation was $5,300,000, but the equivalent of cash received into the Treasury was only $4,300,000. At the time, however, that the major part of this loan was negotiated, a depreciated paper was accepted as a medium of payment; and if one permit this discount to enter into his calculations, he will discover that the specie price of these bonds was a trifle above 70 cents on the dollar. Nor do these figures adequately present the decadence of public credit, for the government found it necessary to resort to unusual devices in order to place the bonds at all. To the extent of $1,900,000, this debt found subscribers in the cities of New York, Philadelphia, and Baltimore, on condition that the amounts subscribed should be expended in the defence of the cities furnishing the money. Such dickering and trading shows the exhausted condition of public credit even more clearly than the discount suffered.

The third attempt to raise money on authority of the act of March 24, marks the collapse of the loan policy. Of the total amount of stock authorized, there remained yet unsold $12,800,000, and we may be sure that the government would have gladly received the entire sum. The amount of stock created was $764,000, the equivalent of cash received being $652,000. The nominal price varied from 80 to 95, the specie price ranging from 65 to 69. Of the moneys thus received, less than $234,000 were available for war purposes, the remainder being paid after the declaration of peace; and of this modest sum, $150,000 were signed by certain corporations of Baltimore to build a frigate for the defence of their own harbor. During the last quarter of the year 1814, receipts

from all sources fell far short of expenditures, so that an actual deficit of $3,800,000 made its appearance in public accounts.

Is not one then justified in the conclusion that the control of the public treasury during the war of 1812 proved a failure? At the beginning of the struggle, Mr. Bacon said that he did not know how long it would be before the Treasury must "wind up business"; the course of events showed that it was possible to run on baseless promises a little over two years. But, it may be asked, was this failure due to the erroneous principles upon which the financial policy was based, or to bad administration? The testimony of contemporary statesmen upon this point is of much importance. In the latter part of 1814, the necessity for new and vigorous revenue legislation came to be quite generally recognized. The President stated this as one of the two reasons for calling an extra session of Congress in September. But the most direct and complete testimony upon this point is found in the financial documents of Mr. Dallas, who was called to administer the Department of the Treasury. "The plan of the finance," said the new Secretary, referring to the policy we have considered, "which was predicated upon the theory of defraying the extraordinary expenses of the war by successive loans, had already become inoperative." Nor did the new Secretary shrink from placing the responsibility of failure where it belonged. The decrease of revenue and the collapse of credit were not ascribed by him to either "the want of resources or the want of integrity in the nation," but "to the inadequacy of our system of taxation to form a foundation of public credit; and the absence from our system of the means which are the best adapted to anticipate, collect, and distribute the public revenue." He proposed the adoption of a new plan of finance, the characterizing feature of which should be "prompt and resolute application to the resources of the country." In addition to the re-establishment of a national bank, his policy embraced three distinct revenue measures. He demanded first, war-taxes, nor did he mean by this expression what Mr. Bacon meant in 1812; second, tax-loans, or temporary loans by means of which the new

taxes could become immediately available; third, an extensive use of treasury notes, approaching a little more nearly our modern idea of legal tenders.[1]

Any criticism upon this plan should be made in view of the fact that two years of inadequate financial administration had bequeathed a legacy of confusion and disordered credit. The problem presented to Mr. Dallas did not consist in forming a war policy which should harmonize in all particulars with the requirements of sound finance, but in rescuing the finances of the country from disaster already experienced. So far as his plan referred to taxes, it is commendable. Twenty-one millions were to be drawn from this source. The tax-loans, also, were demanded by the necessities of the case. It is likewise commendable that he did not at this time make the treasury notes a legal tender for the payment of debts. Yet this would have been the necessary and logical result of the financial policy framed by Mr. Gallatin. They who defend the loan policy always assume that public credit can be maintained by an increase of the tax-levy equal to the current demands of public stock created, but this is found to be a mistake. It is because this is impossible, and because under such circumstances men will not freely lend, that the government feels justified in forcing a loan by means of legal tender notes. The first issue of treasury notes, it will be remembered, was regarded as necessary because of the tardy sale of bonds, and it is but another step in the path already entered upon to give notes a forced circulation. Legal tender notes lie as a germ in the loan policy, and it is probable that the advent of peace alone saved the country from the further calamity their issue would have occasioned.

Some of my readers may be inclined to excuse Mr. Gallatin from all responsibility and to deny that the failure of treasury

[1] This financial plan, submitted by Secretary Dallas, may be found in a letter of October 17, 1814, addressed to the Committee of Ways and Means. The note from the committee asking for suggestions is also significant. Its first sentence is as follows: "The Committee of Ways and Means have had under their consideration the support of public credit by a system of taxation more extended than the one hitherto adopted." *Cf.* Life and Writings of Dallas, pp. 234-243.

administration during the war of 1812 argues aught against the sufficiency of the loan policy proposed by him, because Congress refused to grant the new taxes asked for at the beginning of the war. It is true that the proper administration of the loan policy demands a clear revenue equal to the debt service and the debt expenditure. It is also true that the special tax-bills recommended to the twelfth Congress failed to secure legal sanction; but it would be incorrect to conclude, because these particular taxes were withheld, that the essential requirements of the loan policy were not complied with. A glance at the general balance-sheet covering the three years of the war will show that permanent revenue not only covered permanent expenditure, but furnished a surplus of nearly $6,000,000 for war purposes. Although the new taxes were refused, the receipts from old taxes exceeded expectation; it is impossible, therefore, for the advocates of the loan policy to shift the responsibility of the failure of Mr. Gallatin's policy upon the shoulders of Congress. This balance-sheet is presented in the following table:

TABLE SHOWING THE SOURCE OF MONEYS EXPENDED FOR WAR PURPOSES.

Year ending	War expenditure paid out of proceeds of taxes.	War expenditure paid out of proceeds of loans.
Dec. 31, 1812 . . .	$3,560,150.00	$12,477,988.39
Dec. 31, 1813 . . .	1,399,277.71	24,849,810.41
Dec. 31, 1814 . . .	775,828.53	27,047,309.37[1]
	$5,735,256.24	$64,375,108.17

It thus appears that, for a total war expenditure of some $70,000,000, it was found necessary to create a debt of only $64,300,000, a fact which shows how futile is an apology like that suggested above in favor of the loan policy. So far as clear revenue is concerned, the demands of the theory were met, and it is the theory rather than the remissness of Congress that must be held responsible.

[1] There is included in this sum an actual deficit in accounts.

Or again, it may be that some one, quoting that old maxim *salus populi suprema lex*, a maxim regarded by dullards as the first principle in finance, will ask: Wherein did this policy fail? Did not the government get the money and carry through the war? Such a question can only be answered by placing the actual results of treasury management during the war of 1812 in comparison with the demands of adequate management.

An adequate financial policy will place the credit of the state on so firm a basis, and guard it so jealously, that the government will never be called upon to suffer ruinous discount in the placement of its bonds. The record of this war shows that even at the beginning there was no enthusiam for the public stocks, that every month as it passed saw the nation's credit decline, and that the last quarter of the year 1814 showed a deficit in the public accounts while the government still possessed the right to borrow $12,000,000.

An adequate financial policy will provide such extensive resources that a war once entered upon may be carried through to the end without change of plan. It must be elastic and pliable so as to be ready for all probable emergencies. In the present instance, after little more than two years of vain endeavor to supply the demands of the government, the original plan was abandoned and a new theory adopted by the administration and by Congress. The evils necessarily attendant upon such a change in the midst of a war were only obviated by the return of peace.

An adequate financial policy will not be forced to use treasury notes, except as a convenient method of managing its taxing system. We have already noticed that unwarranted interference with the circulating medium follows logically from a determination to throw the entire weight of war expenditure upon public credit.

It must be admitted that Mr. Dallas passed lightly over this stupendous failure in financial administration, when, in reviewing the financial operations of the war, he said:

> An increase of the expense and a diminution of the supply, must have been anticipated as the inevitable consequences of that event; but

the government reposed with confidence for all the requisite support upon the untried resources of the nation, in credit, in capital, and in industry. The confidence was justly reposed; yet it may perhaps be considered as the subject for regret (and it certainly furnished a lesson of practical policy) that there existed no system by which the internal resources of the country could be brought at once into action, when the resources of its external commerce became incompetent to answer the exigencies of the time. The existence of such a system would probably have invigorated the early movements of the war, might have preserved the public credit unimpaired, and would have rendered the pecuniary contributions of the people more equal as well as more effective. But owing to the want of such a system, a sudden and an almost exclusive resort to the public credit was necessarily adopted as the chief instrument of finance. The nature of the instrument employed was soon developed; and it was found that public credit could only be durably maintained upon the broad foundation of public revenue.

It is not my purpose to follow thus in detail the financial history of the war of 1861. So far as the principles are concerned, it presents nothing with which the foregoing study has not already made us familiar. Here is found the same policy for the management of the public treasury, this policy follows the same course in its developments, and works the same general results. The only variation in the record pertains to the use of treasury notes, for in the case of this second war the loan policy was not arrested until these notes were given the legal power of paying private debts. Upon the main point there can be no question. The plan recommended by Secretary Chase and adopted by Congress was to rely upon public credit for carrying through the war. In a special report of July, 1861, which deals with ways and means, the Secretary expresses himself as follows:

To provide the large sums required for ordinary expenditure and by the existing emergency, it is quite apparent that duties on imports, the chief source for ordinary disbursements, will not be adequate. The deficiencies of revenue, whether from imports or other sources, must necessarily be supplied from loans; and the problem to be solved is that of so proportioning the former to the latter, and so adjusting the details of both, that the whole amount needed may be obtained with certainty,

with due economy, with the least possible inconvenience, and with the greatest possible incidental benefit to the people.

The Secretary has given to this important subject the best consideration which the urgency of varied public duties has allowed, and now submits to the consideration of Congress, with great deference and no little distrust of his own judgment, the conclusions at which he has arrived.

He is of the opinion that not less than eighty millions of dollars should be provided by taxation, and that two hundred and forty millions should be sought through loans.

It will hardly be disputed that in every sound system of finance, adequate provision by taxation for the prompt discharge of all ordinary demands, for the punctual payment of the interest on loans, and for the creation of a gradually increasing fund for the redemption of the principal, is indispensable. Public credit can only be supported by public faith, and public faith can only be maintained by an economical, energetic, and prudent administration of public affairs, and by the prompt and punctual fulfilment of every public obligation:

This financial policy may be more clearly apprehended if one notice the estimates presented by the Secretary. As has been already stated, he proposed to raise $80,000,000 by taxes, as against $240,000,000 by loans. Of this amount of clear revenue, $65,800,000 were required to meet the ordinary expenditures of the peace establishment. It was believed existing laws would provide about $60,000,000, from which it followed that new taxes to the amount of $20,000,000 were required. Of this sum, $9,000,000 were to be devoted to payment of interest upon the new debt, and $5,000,000 to the establishment of a sinking fund for its final expungement. Such was the financial plan upon which this great war was launched.

The revenue law which followed this report modified customs duties so as to intensify the principle of industrial protection, established a three per cent income tax upon all incomes over $800, and apportioned a direct tax of $20,000,000 among the several states. The income tax was not to take effect until January, 1862, and, as the direct tax was apportioned to the South as well as to the North, the Treasury could not hope for the entire amount levied.

In the December report, 1861, the Secretary declared renewed

confidence in the financial plan which he had previously presented. It was found, however, that receipts from customs and from the sale of public lands had fallen off. Thus for the quarter ending September 30, customs duties had yielded but $7,000,000. For the calendar year ending 1861, the government received but $30,000,000 from this source, as opposed to $50,000,000 in 1860, and $53,000,000 in 1859. There seemed, therefore, just ground for apprehension lest existing taxes should fail to support the peace establishment and the loans which the government chose to place. This fear of a deficit from ordinary sources of revenue impressed itself upon the mind of the Secretary, and in consequence he proposed additional duties on tea, coffee, and sugar; a modification of the income tax so as to render it more productive; an increase of the direct tax to the states; and a tax on whiskey, tobacco, bank notes, instruments of conveyance and the like; in short, he proposed the establishment of a system of internal duties. Now all this has the appearance of an abandonment of the loan policy and the adoption of the policy of carrying through the war by taxes, but this is true in appearance only. The total sum of clear revenue hoped for from all these sources of income was but $90,000,000, and this, as the Secretary said, was not more than enough to meet "even economized disbursements, and pay the interest on the public debt, and provide a sinking fund for the gradual reduction of its principal." "It will be seen at a glance," says the report in another place, "that the amount to be derived from taxes forms but a small portion of the sums required for the expenses of the war. For the rest, reliance must be placed on loans." It is also worthy of notice, as throwing additional light upon the policy of the administration, that the mind of the Secretary seems at this time to have been taken up with his scheme for establishing a system of national banking; for, as is well known, one purpose of this scheme was to provide a ready market for public bonds. It comes, therefore, into perfect harmony with the loan policy already adopted.

It was in the latter part of the year 1863, and during the first part of 1864, that the inadequacy of the loan policy as a

basis of war financiering forced itself upon the minds of those who managed public affairs. "To check the increase of debt," says the report of 1863, "must be, in our circumstances, a prominent object of patriotic solicitude." And again, "Hitherto the expenses of the war have been defrayed by loans to an extent which nothing but the expectation of its speedy termination could fully warrant." The report then restated the financial policy as adopted in 1863, and continued:

> The financial administration of the first fiscal year after the outbreak of the rebellion was conducted upon these ideas. The acts of Congress at the extra session of July, 1861, were framed with the intention of supplying the full amount of revenue demanded by them. But receipts disappointed expectation, and it soon became obvious that a much larger proportion of the means needed for the fiscal year 1862, than the principle adopted would allow, must be derived from loans.

But the most interesting expression in this document pertains to the estimates for probable future demands.

> These statements [says the Secretary, referring to the estimates] illustrate the great importance of providing, beyond all contingency, for ordinary expenditures and interest on debt, and for the largest possible amount of extraordinary expenditures, by taxation. In proportion to the amount raised above the necessary sums for ordinary demands will be the diminution of debt, the diminution of interest, and the improvement of credit. It is hardly too much — perhaps hardly enough — to say that every dollar raised for extraordinary expenditures or reduction of debt is worth two in the increased value of national securities, and increased facilities for the negotiation of indispensable loans.

Could this truth have been recognized at the beginning of the war, and could it at that time have influenced the treasury policy, the financial history of the last twenty-five years would have been materially modified.

Congress also, in the latter part of 1863, began to recognize the essential weakness of the loan policy, and to turn its attention to the necessity of taxes for distinctively war purposes. The great tax-bills of the war were those of June, 1864. Mr. Morrill, in whose speech of a year before there were statements showing that the original policy was yet intact, admitted,

while presenting these new bills, that money must now be secured by every possible means.

The Treasury [he said] requires a large supply of means, and such sources of revenue as have not already yielded their maximum contributions must now be sought, so that we may fill the measure of our wants. . . . This measure [the proposed bill] is intended as a war measure, a temporary measure, and it is needful that it pass speedily. Every day's delay in the passage of this and the internal revenue bill costs the Treasury not less than $500,000.

This language is very different from the financial dilettantism that marked the attitude of our financiers during the first two years of the war.

It is somewhat difficult to exhibit accurately the rapid fall of public credit from 1861 to 1866; but I have undertaken in the following statement to approximate such an exhibit by showing the specie price of all the obligations issued during the war. The computation has been made by estimating the value of the total receipts from credit for each quarter, at the average price of gold during that quarter. The only source of error in this method arises from the fact that the average price of gold for any three months may not be the actual price at which the proceeds of bonds were covered into the Treasury, but any closer computation requires more complete data than the authorities at Washington have yet given. It is, however, believed that the conclusions may be relied upon as substantially correct.

TABLE SHOWING TREASURY RECEIPTS FROM PUBLIC OBLIGATIONS OF ALL SORTS FOR EACH QUARTER DURING THE WAR, AND THE GOLD VALUE OF SUCH RECEIPTS ESTIMATED ON THE AVERAGE PRICE OF GOLD FOR EACH QUARTER.

For the quarters ending	Gross receipts from debt created.	Gold value of gross receipts.	Percentage realized.
Mar. 31, 1862	$60,947,202.67	$59,527,132.84	97.67
June 30, 1862	209,049,203.81	200,230,763.59	95.78
Sept. 30, 1862	68,934,420.36	59,648,953.94	86.54
Dec. 31, 1862	131,631,479.40	101,250,933.95	76.92

Table showing Receipts from Public Obligations — continued.

For the quarters ending	Gross receipts from debt created.	Gold value of gross receipts.	Percentage realized.
Mar. 31, 1863	$178,569,759.25	$115,195,351.69	64.51
June 30, 1863	216,460,067.49	145,829,147.47	67.37
Sept. 30, 1863	118,267,491.75	89,800,506.48	75.93
Dec. 31, 1863	150,450,843.85	100,862,245.72	67.40
Mar. 31, 1864	191,922,104.42	120,220,006.20	62.64
June 30, 1864	235,371,791.92	122,581,629.23	52.08
Sept. 30, 1864	147,735,822.42	61,295,592.72	41.49
Dec. 31, 1864	179,908,674.29	80,365,204.80	44.67
Mar. 31, 1865	175,313,376.72	88,094,971.80	50.25
June 30, 1865	361,905,625.74	253,406,319.14	70.02
Sept. 30, 1865	138,765,727.22	97,038,873.04	69.93

SUMMARY FOR THE YEARS ENDING

Dec. 31, 1862	$470,562,306.24	$430,657,784.32	91.58
Dec. 31, 1863	663,748,162.34	451,687,251.35	68.05
Dec. 31, 1864	754,938,393.05	384,462,432.95	50.93
Sept. 30, 1865	675,984,729.68	438,540,163.98	64.87
Summary for the 45 months of the war	$2,565,233,591.31	$1,705,347,632.60	66.48

It seems superfluous to comment on such figures as these. A treasury administration that permits the credit of a wealthy people to decline so that its obligations fall fifty per cent and remain there for a year, can hardly be called successful. Yet the results here displayed, as also the forced circulation of treasury notes, are the natural fruit of an endeavor to carry through a war by loans.

But the lesson of these public accounts is not fully appreciated until it is observed with what ease a system of internal revenue may be made to respond to a vigorous and decided administration, for this shows how unnecessary it is to rely wholly upon public credit for extraordinary expenditures. In this connection the following table is pertinent for our consideration.

TABLE SHOWING RECEIPTS FROM VARIOUS SOURCES IN DENOMINATIONS OF MILLIONS.

	1861.	1862.	1863.	1864.	1865.	1866.
Customs revenue	39.5	49.0	69.0	102.3	84.9	179.0
Internal revenue		1.7	39.1	110.2	210.6	311.2
Miscellaneous	1.8	11.2	4.5	52.1	38.2	67.8
Clear revenue	41.3	61.9	112.6	264.6	333.7	558.0
From loans	23.7	433.6	595.6	696.0	864.8	92.6
Total revenue	65.0	495.5	708.2	960.6	1198.5	650.6

It requires no extended study to discover the meaning of these figures. The criticism which they offer makes its appearance when one asks what would probably have been the financial consequences could the receipts from internal revenue have been moved ahead two years. Suppose, for example, that Secretary Chase could have received from this source $110,000,000 in 1862, $210,000,000 in 1863, and $311,000,000 in 1864 — what a change would it have produced in the course of financial administration! Its moral effect upon the South, working especially through their European sympathizers, would have brought the war to a more speedy termination, the credit of the government could not have suffered as it did, while the advocates of legal-tender money would have been deprived of the argument of necessity. Now the responsibility for the tardy flow of revenue from internal duties is traceable to the policy upon which the finances of the war were set on foot, and not to the inability or to the reluctance of the country to pay. Secretary Chase denied the necessity of meeting any part of war expenditure from war taxes, because the financial theory which he espoused deprecated the endeavor; and it required nearly three years of disastrous treasury management to convert the administration and Congress from this erroneous theory. In view of actual conditions, it is perhaps a little extravagant to suppose that the receipts from internal revenue could have been advanced two years, but it is altogether

reasonable to conclude that a vigorous administration might have anticipated actual results by eighteen months. This estimate allows nearly a year for the establishment of the system, and claims only that internal revenue should have begun to come into the Treasury at the rate of $9,000,000 a month as early as July, 1862. And when it is noticed how quickly the industries of the country responded to the laws of 1864, as shown by the receipts for the year 1865, one cannot regard this claim as at all impracticable. There is here disclosed the fundamental error of that theory which looks to credit as the only source of war expenditures. It is blindly optimistic and so deprecates an appeal to sources of revenue that might with ease be opened. They who undertake its administration are sure to let matters drift until disaster awakens them to the fact that the financial problem is no longer under their control. This theory springs from financial ignorance, from a sense of administrative weakness, and from a thorough distrust of the people.

It appears, then, that the history of the war of 1861, like that of 1812, bears direct testimony against the sufficiency of the loan policy. It is no apology for the men who administered public affairs that they looked upon the action of the South as a local insurrection, for, in matters of public financiering, revenue must conform to necessary expenditure; and no policy can meet approval which fails to supply all the money that is needed for as long a time as it is needed.

III.

What is the true plan for the financial management of a war?

Thus far our argument has proceeded according to the logic of exclusion. We have learned that the tax policy does not conform to well-known principles of human nature, and that the loan policy fails to bear the test when tried; but since taxes and loans are the only sources of revenue open to modern financiers, it follows that the true policy must embrace them both. Our further study, therefore, must concern itself with

inquiring what constitutes a reasonable union of taxes and loans.

We shall be assisted in answering this question if we notice at the outset certain financial principles or truths that point to the correct theory of treasury management. First, the habit of bearing taxes is one easily acquired, if only the instruction be given in a proper manner. It is never necessary to depend altogether upon loans for war expenditure, and the administration that shrinks from a levy of taxes lest the war spirit be chilled shows either a doubtful cause or a weak-kneed cabinet. As a second principle may be stated the fact that it is easier to raise the rate of existing taxes than to establish a new system. From this it follows that the germ of a war policy lies back in the treasury policy of ordinary times. Again, it is popular support rather than the adherence of a syndicate of banks which ensures the success of a financial policy. This is true because popular sentiment in favor of the administration guarantees the support of the banks, but it is not true that the support of the banks brings with it general enthusiasm. This does not mean that banks should never be employed as agents of the government, but that the administration should be superior to the criticisms of the banking interest, that the basis of its operations should be as broad as possible, and that it is no sign of weakness to appeal to patriotism as a motive for lending money. And lastly, it is a truth worth remembering that democratic peoples are willing to go all lengths with a government which takes them into its confidence. It is assumed that the purpose of the war is approved, otherwise there is no apology for undertaking it; but, granting this, personal sacrifice and assistance are assured to a government so long as the public continues to have confidence in the efficacy of its administration. The meaning of this fact is, that an adequate financial policy should be bold, courageous, sufficient, and simple; that it should lie close to the sympathies of the people, and not fear to make from them searching demands. We have now before us the raw material out of which to construct a plan for the management of a war.

Coming then directly to the question in hand, it is of prime necessity to recognize that good financiering in times of emergency is only possible upon the basis of an adequate revenue system previously established. It must be recognized that some preparation in time of peace should be made against the advent of war, but the dedication of a particular tax to this purpose, or the accumulation of a war reserve, does not accord with the most perfect financial requirements. How then may the peace establishment provide against unusual demands? As the matter appears to me, nothing more is required for this purpose than that the permanent revenue system should be so constructed as to respond quickly to any change in rates imposed. Under such a condition, income fluctuates directly with any modification in rates; but if the actual rate of taxation in ordinary times be at or above this revenue rate, the administration can hope for no assistance from the established taxing system in case of an emergency. An increase in the rate would probably decrease revenue by decreasing the consumption of taxed commodities. The government thus finds itself embarrassed at the outset, and easily persuades itself that an appeal to credit is the only method of making headway against demands. But if we suppose, on the other hand, that the country possesses a broad system of taxation, so that ordinary demands may be met by imposing low duties, any embarrassment encountered by the minister of finance at the beginning of a war must be of his own making.

Assuming such provisionary measures to have been taken, what is the next step in an adequate war policy?[1]

Our answer may be given without hesitation. New sources of revenue must be opened by the levy of new taxes. But, it may be asked, is not such a proposal a virtual abandonment of the loan policy? This cannot be admitted; for it is essential that a law should be passed to provide for clear revenue in addition to that secured by raising the rate upon existing

[1] In view of the peculiar relation existing between the federal government and the several states of the American Union, there are many reasons for saying that, in our country, this first tax should be a direct tax upon the states, appropriated and collected on the principle of "Revolutionary requisitions."

taxes, before a financier has any right to assume that he can borrow extensively without depressing public credit. He cannot rely entirely upon the new revenue derived from the old taxes, because this revenue is not co-existent with the debts created. A true financial policy also must hold in view the termination of a war as well as its continuance, and do nothing which can in any manner obstruct a speedy reduction in the rate of permanent taxes upon a return of peace. For, if the extraordinary income from the permanent taxes be mortgaged to the support of a permanent debt, the first claim of a good revenue system is disregarded. The elastic quality of the system would be thereby destroyed, and the country would be poorly prepared to meet another financial emergency. And it must be further noticed that these new taxes once established and brought into running order, are ready at hand to assist in the expungement of debts when the war shall have terminated. It thus appears that the new taxes tend to strengthen public credit even before they become remunerative; they relieve the temporary revenue so that it may again serve as the temporary basis of new loans; and they assume the whole weight of the debt upon the return of peace.

It may be objected to the plan here proposed that, should the struggle prove of slight duration and little cost, the country is burdened with a lot of useless taxes; but this objection seems to be made without due consideration. Assuming that the difficulty is quickly terminated, it is more than probable that the strong financial policy adopted by the administration rendered great assistance in attaining so desirable an end. If a destructive war can be obviated by the voting of taxes, there are few who would withhold their assent. Nor is it necessary, in the case assumed, that the taxes should prove an actual burden to the people. New taxes require some considerable time before they become productive, and should the occasion for them pass away, they may be abolished before taking much from the pockets of the people. Let then no financier argue that a war demand will probably be small and that it may be met by loans without an appeal to taxes; for the administra-

tion certainly needs the moral influence of the tax-laws, the revenues which these laws are capable of bearing may be required, and if the events show the solicitude of the administration to have been groundless, no great harm is done.

It remains for us to consider what use should be made of public credit, and to discover the principle according to which the extraordinary expenditure should be apportioned between loans and taxes. The theory of public borrowing is very simple. Public credit should always be regarded as a means of anticipating revenue. It is a short cut to capital; and the first great service of loans in time of war is to give the administration immediate control over capital upon the declaration of hostilities. But such borrowing does not necessarily create a permanent debt. It rests in the first instance upon the extraordinary receipts arising from the increase of rate in the permanent revenue system. Should the war, however, continue for any considerable time, it would be necessary to convert the debt thus created into a permanent debt and assign it to new funds for support. And here, it may be said, is the only point at which ignorance of the probable duration of the extraordinary demands may be permitted to influence the financial policy of the administration. It is proper, until the future may be forecast with some degree of certainty, that temporary debts rather than permanent debts should be used. And here, too, is disclosed the peculiar service rendered by an elastic revenue system, for the quick command which such a system grants over revenue provides a solid basis of credit at the beginning of the war, and so insures a good price for the first bonds negotiated.

There is another and more important service that may be rendered by loans. When a government gives bonds in return for capital, the individual who supplies the capital does not feel that sense of personal loss which attends the payment of a tax. He has merely changed the character of his property. It thus appears that by means of loans a government may hope to secure immediate control over large funds of capital while yet allowing the motives for continued industry full liberty of

action. So far as it seems necessary to use credit for attaining this end, the obligations created against the state must run for some considerable time, and be assigned to a reliable fund for the payment of the annual interest which they demand.

In the services here brought to view lies the entire theory of public credit. Loans are always a means of anticipating assured revenue. No other meaning can be attached to them when used to carry through the financial operations of a war, for no system has yet been devised for evading the necessity of extraordinary taxes as the result of extraordinary expenditures. Our general conclusion then is, that sound financial management inclines always towards taxes. The measure of the amount that may be secured by this means is found in their observed effect upon current industry, for the demand for clear revenue must never go so far to discourage industrial activity.

It is impossible to proceed much farther in a general discussion of this subject, for the conflicting interests to be harmonized and the importance of the factors that enter into the problem must influence greatly the application of the principles suggested. It may, however, be permitted to take one step in the direction of formulating a rule of wide application for the financial conduct of a war, by which the relative use to be made of taxes and loans may be roughly indicated. At the beginning of hostilities, revenue from loans may properly outbalance revenue from taxes, but as the war progresses, and the demands increase, taxes should be continually forced into greater prominence.

There are several considerations that favor this rule. Thus the necessity for temporary loans is always greater at the beginning of a war than at any subsequent period. As the newly levied taxes become more and more productive, and as the people become accustomed to high rates of payment, the legitimate use of loans becomes narrowed. But the most forcible reason favoring the rule is the following. The great stress which the advent of war throws upon industry arises from the necessary readjustment of labor to a new line of demands. A condition of war is not a condition of peace, from any point of

view, and the industrial transition from the one to the other is always attended with danger and may prove the occasion of disaster. But if the financier can only bridge over this chasm and establish business firmly on a war basis, he may extend his taxing system with as much confidence as if the people were living in a state of profound peace. It is during this period of readjustment that public credit renders its greatest service to the administration. At no future time during the continuance of a war can such strong reasons be urged in favor of its employment.

It seems, then, that the theory for the administration of a treasury during the continuance of a war contemplates first, the formation of a financial policy at the time when hostilities are first declared; and second, the development of a policy after industries are well adjusted to belligerent conditions. As has been set forth in the foregoing analysis, the formation of the policy demands the legalization of three fiscal measures.

1. The rate of taxation in the permanent revenue system must be raised. The new income thus secured will serve as the basis of the first loans and, when relieved by other funds, may be employed as a contingent fund or as a source of war expenditure. Nothing must be done to endanger the repeal of this measure upon a return of peace.

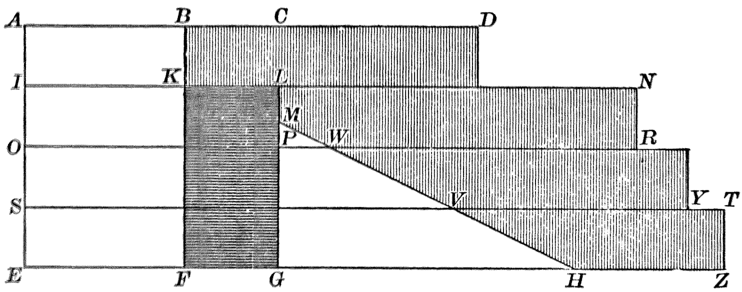
2. New sources of revenue must be opened by the levy of new taxes. The estimated proceeds of these taxes must exceed, if possible, the demands of loans for interest payment. This will assist in maintaining the credit of the state, it will give some revenue for war purposes while hostilities continue, and will provide revenue for the expungement of the debt when the demands for war expenditures shall have ceased.

3. A large loan, equal to the satisfaction of all possible demands, must be authorized, and the minister of finance must be granted large discretionary powers in its placement. In this manner there is created the machinery for financial operations, and under a strong administration there is little fear of failure.

The principles which control the development of the policy are the same as those which shape its establishment. If tem-

porary loans were resorted to, they should be funded upon the proceeds of the new taxes as soon as possible. The financier may hope for assistance from his new taxes within eighteen months of their levy, and if demands continue to expand, his call for clear revenue should be gradually increased until revenue machinery is speeded to its highest productive capacity. But there is a limit to the possible war consumption, and with gradually increasing income from taxes clear revenue must eventually overtake any possible demand.

This theory of treasury management may, perhaps, be more clearly apprehended if stated with the assistance of the following diagram.



In this figure the horizontal lines, in the direction from left to right, measure the productivity of revenue machinery, while the perpendicular distance is assumed to represent the time through which it operates. Thus the line *AB* shows the intensity of the demand made upon the permanent revenue establishment in times of peace, and since the line *AI* covers one year's time, the parallelogram *AK* represents the normal income for a year. Now the first measure, upon the outbreak of a war, is to increase the rate imposed upon the peace establishment. Let it then be increased by *BC*. If now the permanent system has been formed according to correct principles and is elastic in character, this advance in the rate of imposition will yield increased revenue; but since it is necessary to properly advertise this change, it is assumed that this addition to clear receipts will not make its appearance till the beginning of the second year. It follows then that the entire war demand of the first year must

come from loans. This is represented in the figure by the parallelogram *KD*. There is no danger, however, but that this stock will bear good prices, because it rests upon income assured by revenue machinery already in operation. This fund which sustains the credit of the government during the first year is represented by the parallelogram *KP*, from which it appears that the entire receipts flowing from the permanent establishment during the second year is equal to the parallelogram *IP*. During the second year, also, the newly established taxes begin to lend their assistance in carrying on financial operations, and the income from this source is represented by the triangle *MPW*. This revenue is shown as beginning in the middle of the second year because it will probably take eighteen months to bring an entirely new system into working order. It thus appears that a large share of the extraordinary expenditure of this year also must be secured from loans, which is represented in the diagram by the figure *LMWRN*. But with the beginning of the third year, it may be assumed that the industrial readjustment has taken place, and the financier may constantly and persistently extend his demand for clear revenue; and since there is a limit to war consumption, the necessity of loans decreases with every increase in clear revenue. Thus the total revenue for the third year is represented by the parallelogram *OY*, of which clear revenue provides a sum represented by the figure *OSVW*, the remainder being supplied by loans. The fourth year demands a total expenditure represented by *SEZT*, but loans are called upon to furnish the comparatively small sum of *VHZT*. It lies as an essential part of the treasury policy here defended that the newly established system of taxation should be continuously expanded until financial exigencies shall have passed away; and this may be brought about either by a return of peace, or by the fact that clear revenue has overtaken war demands. It is useless to say that this is impossible; it is perfectly feasible, provided only a strong and vigorous policy be adopted at the beginning of the war. The difficult part of the task imposed upon the financier is during the first and second years of the war. At this time there is demand for

wisdom and firmness, for no administration can recover itself if it indulge in weakness and inefficiency when a policy is set on foot.

Our conclusion, then, respecting the appropriate financial policy for the conduct of a war is the following. Reliance cannot be placed wholly upon loans nor wholly upon taxes, but fiscal administration should be so adjusted as to gradually change the burden of expenditures from credit to clear income.

HENRY C. ADAMS.